

DESCRIPTION OF TAX BILLS

(S. 639, S. 702, AND S. 738)

SCHEDULED FOR A HEARING

BEFORE THE

**SUBCOMMITTEE ON TAXATION AND
DEBT MANAGEMENT**

OF THE

COMMITTEE ON FINANCE

ON MAY 8, 1981

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION



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C O N T E N T S

	<i>Page</i>
Introduction.....	1
I. Summary.....	3
II. Description of Bills.....	5
1. S. 639 (Senators Packwood and Bentsen): Incentive stock options.....	5
2. S. 702 (Senators Baucus, Packwood, Cannon, Riegle, Bentsen, Wallop, Matsunaga, Boren, Symms, Durenberger, Jepsen, and Kassebaum): Deduction for diminution in value of motor carrier operating authorities.....	9
3. S. 738 (Senator Durenberger): Advance refunding of St. Paul Port Authority revenue bonds.....	13

INTRODUCTION

The bills described in this pamphlet have been scheduled for a public hearing on May 8, 1981, by the Senate Finance Subcommittee on Taxation and Debt Management.

There are three bills scheduled for the hearing: S. 639 (relating to incentive stock options), S. 702 (relating to deduction for diminution in value of motor carrier operating authorities), and S. 738 (relating to advance refunding of St. Paul Port Authority revenue bonds).

The first part of the pamphlet is a summary of the bills. This is followed by a more detailed description of the bills, including present law, issues, an explanation of the bills, effective dates, and estimated revenue effects.

I. SUMMARY

1. S. 639—Senators Packwood and Bentsen

Incentive Stock Options

Under present law, the value of a stock option granted by an employer to an employee is taxed, when the option is received, as ordinary income to the employee only if the option itself has a readily ascertainable fair market value. If the option does not then have a readily ascertainable value, the spread between the value of the stock received on exercise and the option price is taxed, when the option is exercised, as ordinary income to the employee. The employer generally is allowed a business expense deduction corresponding to the ordinary income taxed to the employee (Code sec. 83).

Under the bill, a compensatory stock option which meets certain requirements (called an "incentive stock option") would not result in taxation to the employee either when the option is granted or when the option is exercised. Instead, when stock received on exercise of the option is sold, the employee generally would be taxed at capital gains rates on the difference between the amount received for the stock and its basis (the option price). The employer would receive no deduction with respect to an incentive stock option.

Generally, the bill would apply to options exercised after December 31, 1980.

2. S. 702—Senators Baucus, Packwood, Cannon, Riegle, Bentsen, Wallop, Matsunaga, Boren, Symms, Durenberger, Jepsen, and Kassebaum

Deduction for Diminution in Value of Motor Carrier Operating Authorities

Under present law (Code sec. 165), a deduction is allowed for a loss incurred in a trade or business which is sustained during the taxable year and not compensated for by insurance or otherwise. In general, the amount of the deduction equals the adjusted basis of the property involved.

As a general rule, no deduction is allowed for a decline in value of property absent a sale, abandonment, or other disposition of the property. In several decisions, courts have denied a loss deduction where the value of an operating permit or license was reduced as a result of legislation expanding the number of licenses or permits which could be issued. These decisions held that the diminution in the value of a license or permit did not constitute an event giving rise to a loss deduction under Code section 165 where the license or permit continued to have value as a right to carry on a business.

The bill provides that a deduction would be allowed ratably over a 36-month period (generally, beginning July 1, 1980) for taxpayers who held motor carrier operating authorities on July 1, 1980, the date of enactment of the Motor Carrier Act of 1980. (The 1980 statute lessened restrictions existing pursuant to prior law and administrative practices on entry into interstate motor carrier business, as a result of which holders of operating authorities had been afforded protection against competition; however, an operating authority still must be obtained to conduct interstate motor carrier business.) The amount of the deduction would be the greater of \$50,000 or the total adjusted basis of all motor carrier operating authorities held by the taxpayer on July 1, 1980 (or acquired after that date under a binding contract in effect on July 1, 1980).

The provisions of the bill would be effective for taxable years ending after June 30, 1980.

3. S. 738—Senator Durenberger

Advance Refunding of St. Paul Port Authority Revenue Bonds

Under present law, interest on certain industrial development bonds qualifies for tax exemption if substantially all the bond proceeds are used to provide certain "exempt activity" facilities. Interest on a refunding issue of a tax-exempt industrial development bond more than six months in advance of the retirement of the original bonds qualifies for tax exemption only if substantially all the proceeds of the refunded issue were used to provide a qualified public facility. Qualified public facilities include airports, docks, wharves, mass commuting facilities, and parking facilities (and related storage or training facilities) which are available for use by the general public (Code sec. 103(b)(7)).

Under the bill, interest on an advance refunding issue of industrial development bonds would be exempt from taxation, without regard to the present-law public use requirement, provided that: (1) the refunding issue is secured by a pledge of substantial revenues of the issuer derived from 20 or more facilities operated or leased by the issuer; (2) the refunding issuer is a political subdivision engaged primarily in promoting economic development; (3) the issuer was created under State law at least 20 years prior to the issuance of the refunding bonds for the express purpose of promoting economic development; and (4) any debt service savings derived from the refunding are to be used only for the proper corporate purposes of the issuer and not to reduce any existing obligation of a nonexempt person (i.e., any person other than a State or local government or tax-exempt organization).

The bill is intended to benefit the Port Authority of the City of St. Paul, Minnesota. The provisions of the bill would be effective on enactment.

II. DESCRIPTION OF BILLS

1. S. 639—Senators Packwood and Bentsen

Incentive Stock Options

Present law

Under present law, the taxation of stock options granted by an employer to an employee as compensation is governed by Code section 83. The value of the option constitutes ordinary income to the employee when granted only if the option itself has a readily ascertainable fair market value at that time. If the option does not have a readily ascertainable value when granted, it does not constitute ordinary income at that time. Instead, when the option is exercised, the spread between the value of the stock at exercise and the option price constitutes ordinary income to the employee. Ordinary income on grant or on exercise of a stock option is treated as personal service income and hence generally taxed at a maximum rate of 50 percent.

An employer which grants a stock option generally is allowed a business expense deduction equal to the amount includible in the employee's income in its corresponding taxable year (Code sec. 83(h)).

Background of tax treatment of stock options

Restricted stock options

The Revenue Act of 1950 enacted provisions for "restricted stock options," under which neither grant nor exercise of the option gave rise to income to the employee. Instead, income generally was recognized at the time the employee sold stock which had been received pursuant to exercise of the option. No deduction was allowed to the employer matching the amount of income recognized by the employee (the gain on sale of the stock).

If the option price was at least 95 percent of the market price of the stock at the time the option was granted, the entire amount of any gain realized by the employee at the time the stock was sold was treated as capital gain. If the option price was between 85 and 95 percent of the market price at the time the option was granted, the difference between the market value of stock at the time of the option grant and the option price was treated as ordinary income when the stock was sold, and any additional gain at the time the stock was sold was treated as capital gain.

For a stock option to be classified as "restricted," the option price had to be at least 85 percent of the market price of the stock at the time the option was granted; the stock or the option had to be held by the employee for at least two years after the date of the granting of the option, and the stock held for at least six months after it was transferred to the employee; the option could not have been transferable other than at death; the individual could not have held ten percent or more of the stock of the corporation (unless the option price

was at least 110 percent of the fair market value); and the option could not have been for a period of more than ten years.

Qualified stock options

The Revenue Act of 1964 repealed the restricted stock option provisions and enacted provisions for "qualified stock options." These qualified stock options generally were taxed similarly to restricted stock options.

Qualified options had to be granted with an option price of at least the stock's market price when the option was granted (subject to a 150-percent inclusion in income where a good faith attempt to meet this requirement failed). In addition, qualified stock options were subject to the requirements that the stock had to be held three years or more; the option could not be held more than five years; stockholder approval had to be obtained; the options had to be exercised in the order granted; and no option could be granted to shareholders owning more than five percent of the stock (increased up to ten percent for corporations with less than \$2 million equity capital).

1969 Tax Reform Act—Minimum tax and maximum tax

The Tax Reform Act of 1969 enacted a minimum tax, under which a tax was imposed equal to ten percent of the items of tax preference (reduced by a \$30,000 exemption plus regular tax liability). Both the bargain element on restricted and qualified stock options and the excluded portion of capital gains were items of tax preference.

In addition, a 50-percent maximum marginal tax rate on income from personal services was added by the 1969 Act. Income eligible for this rate was reduced generally by the sum of the items of tax preference in excess of \$30,000.

1976 Tax Reform Act—Repeal of qualified stock options

The Tax Reform Act of 1976 repealed qualified stock option treatment for options granted after May 20, 1976 (except for certain transitional options which will cease to be qualified after May 20, 1981). The 1976 Act also increased the minimum tax rate to 15 percent, reduced the exemptions for the minimum and maximum tax, and permitted deferred compensation to qualify for the 50-percent maximum rate on personal service income.

Revenue Act of 1978—Treatment of capital gains

The Revenue Act of 1978 removed the excluded portion of capital gains from the minimum and maximum tax and made it subject to a new alternative minimum tax. In addition, taxes on capital gains were reduced, so that the maximum rate of tax on capital gains is 28 percent.

Issue

The principal issue is whether to reinstitute rules for tax treatment of stock options under which the employee would not recognize income on receipt of the option or exercise of the option, the employee would be taxed only at capital gains rates at the time the stock is sold, and the employer would not receive a deduction with respect to the option.

Explanation of the bill

In general

The bill would enact provisions for "incentive stock options," which would be taxed in a manner similar to the tax treatment previously

applied to restricted and qualified stock options. That is, there would be no tax consequences when an incentive stock option is granted or when the option is exercised, and the employee would be taxed at capital gains rates when the stock received on exercise of the option is sold. Similarly, no business expense deduction would be allowed to the employer with respect to an incentive stock option.

The term "incentive stock option" would mean an option granted to an individual, for any reason connected with his or her employment, by the employer corporation or by a parent or subsidiary corporation of the employer corporation, to purchase stock of any of such corporations.

Requirements (holding period, etc.)

To receive incentive stock option treatment, the bill would provide that the employee must not dispose of the stock within two years after the option was granted, and must hold the stock itself for at least one year. If all requirements other than these holding period rules are met, the tax would be imposed on sale of the stock, but gain would be treated as ordinary income rather than capital gain, and the employer would be allowed a deduction at that time.¹

In addition, for the entire time from the date of granting the option until three months before the date of exercise, the option holder must be an employee either of the company granting the option, a parent or subsidiary of that corporation, or a corporation (or parent or subsidiary of that corporation) which has assumed the option of another corporation as a result of a corporate reorganization, liquidation, etc. This requirement and the holding period requirements would be waived in the case of the death of the employee.²

Terms of option

For an option to qualify as an "incentive stock option," the bill would provide that the terms of the option itself would have to meet the following conditions:

1. The option must be granted under a plan specifying the number of shares of stock to be issued and the employees or class of employees to receive the options. This plan must be approved by the stockholders of the corporation within 12 months before or after the plan is adopted.
2. The option must be granted within ten years of the date the plan is adopted or the date the plan is approved by the stockholders, whichever is earlier.
3. The option must by its terms be exercisable only within ten years of the date it is granted.
4. The option price must equal or exceed the fair market value of the stock at the time the option is granted. This requirement would be deemed satisfied if there had been a good faith attempt to value

¹ In the case of a sale which does not meet the holding period requirements, the amount of ordinary income, and the amount of the employer's deduction, would be limited to the difference between the amount realized on the sale and the option price.

² For purposes of the holding period requirements, the bill also would provide that certain transfers by an insolvent individual of stock received pursuant to exercise of an incentive stock option are not to be treated as dispositions of such stock. The transfers which would be covered by this rule are transfers to a trustee, receiver, or similar fiduciary, or other transfers for the benefit of the individual's creditors, in a bankruptcy case or similar insolvency proceeding.

the stock accurately, even if the option price was less than the stock value.

5. The option by its terms must be nontransferable other than at death and must be exercisable during the employee's lifetime only by the employee.

6. The employee must not, immediately before the option is granted, own stock representing more than ten percent of the voting power or value of all classes of stock of the employer corporation or its parent or subsidiary.³ However, the stock ownership limitation would be waived if the option price is at least 110 percent of the fair market value (at the time the option is granted) of the stock subject to the option and the option by its terms is not exercisable more than five years from the date it is granted.

Other rules

The bill would provide that stock acquired on exercise of the option could be paid for with stock of the corporation granting the option.

The difference between the option price and the fair market value of the stock at the exercise of the option would not be an item of tax preference.

Also under the bill, any option which is a qualified stock option or restricted stock option under present law would become an incentive stock option if it was not exercised before January 1, 1981, and if it otherwise satisfies requirements for incentive stock options.

Effective date

The bill generally would apply to options exercised after December 31, 1980. However, in the case of an option which was granted on or before December 31, 1980 and which was not a qualified option, the corporation granting the option could elect (within six months after enactment of the bill) to have the option not treated as an incentive stock option.

In the case of an option granted before 1982, the modification or deletion of any stock appreciation right or right to receive cash payments to permit the option to qualify as an incentive stock option could be made within six months of the enactment of the bill without the modification being treated as the grant of a new option.

Revenue effect

It is estimated that the bill would reduce budget receipts by a negligible amount in fiscal year 1981 and by less than \$5 million annually in fiscal years 1982 through 1984. It is further estimated that this bill would increase budget receipts by \$15 million in fiscal year 1985 and by \$30 million in fiscal year 1986.

Prior Congressional action

In the 96th Congress, the Senate Finance Committee reported a bill (H.R. 5829, sec. 224) including substantially identical provisions for incentive stock options (Sen. Rpt. 96-940). No further action was taken on that bill.

³ For this purpose, the individual would be considered to own stock owned directly or indirectly by brothers and sisters, spouse, ancestors, and lineal descendants, and stock owned directly or indirectly by a corporation, partnership, estate, or trust would be considered as being owned proportionately by shareholders, partners, or beneficiaries.

2. S. 702—Senators Baucus, Packwood, Cannon, Riegle, Bentsen, Wallop, Matsunaga, Boren, Symms, Durenberger, Jepsen, and Kassebaum

**Deduction for Diminution in Value of Motor Carrier
Operating Authorities**

Present law

Background

Enacted in 1935, Part II of the Interstate Commerce Act (the "1935 Act") provided the basic framework for regulation of the motor carrier industry until enactment of the Motor Carrier Act of 1980. Under the 1935 Act, carriers were obligated to provide nondiscriminatory service at regulated rates for the public convenience and necessity, and further industry regulation was effected by issuing or withholding certificates of operating authority.

During the period 1935 to 1980, the Interstate Commerce Commission ("ICC") granted a limited number of permits and certificates of operating authority to motor carriers and freight forwarders. The basis for the grant of an authority from the ICC was a showing that additional service of the type for which authority was sought was or would be required by the public convenience and necessity. Businesses with existing operating rights could intervene in a proceeding for a request of operating authority to show that the proposed service was not or would not be required by the public convenience and necessity.

The right of existing operators to intervene (based on ICC procedural rules) and the applicant's burden of showing that the proposed service was required by the public convenience and necessity (based on the 1935 Act) gave existing operators protection against competition. Persons wishing to either enter the motor carrier business or expand an existing business therefore often would purchase an existing business with its operating authority.

Substantial amounts were paid for these operating authorities, reflecting, in part, the protection against competition afforded to authority owners under ICC administration of the 1935 Act. The value of the operating authorities provided owners with an asset that constituted a substantial part of a carrier's asset structure (sometimes amounting to over 50 percent of a concern's assets) and a source of loan collateral.

In 1975, the ICC began to grant a higher percentage of requests for operating authorities under the standard of "required by the public convenience and necessity." On July 1, 1980, the Motor Carrier Act of 1980 was enacted (P.L. 96-296). Under the 1980 Act, applicants do not need to show that the proposed service is required by the public convenience and necessity. Existing operators protesting the grant of an authority bear the burden of showing the proposed service is inconsistent with that standard. Thus, the 1980 statute further lessened

restrictions existing pursuant to prior law and administrative practices on entry into interstate motor carrier business. However, an operating authority still must be obtained in order to conduct interstate motor carrier business.

The ICC, following an opinion of the Financial Accounting Standards Board, has required that the value assigned to certificates of authority in the regulated books of motor carriers be written off in one year.

Deduction for realized loss of property

Section 165 of the Code allows a deduction for certain losses, including any loss incurred in a trade or business which is sustained during the taxable year and not compensated for by insurance or otherwise. In general, the amount of the deduction equals the adjusted basis of the property involved (Code sec. 165(b)).

Treasury regulations provide that to be allowable as a deduction, the loss must be realized, i.e., "evidenced by closed and completed transactions, fixed by identifiable events" (Reg. § 1.165-1(b)). As a general rule, no deduction is allowed for a decline in value of property absent a sale, abandonment, or other disposition of the property¹ nor for loss of anticipated income or profits.² Thus, in order for a loss to be allowed under present law, generally either the business must be discontinued or the property must be abandoned or permanently discarded from use in the business (Reg. § 1.165-2). Generally, if a capital asset declines in value and is sold or exchanged at a loss, the loss is a capital loss, the deduction of which is subject to the limitations of Code sections 1211-1212 (Code sec. 165(f)).

The courts in several decisions³ have denied a loss deduction where the value of an operating permit or license decreased as a result of legislation expanding the number of licenses or permits which could be issued. These decisions held that the diminution in the value of a license or permit did not constitute an event giving rise to a loss deduction under Code section 165 where the license or permit continued to have value as a right to carry on a business.

In the *Consolidated Freight Lines* case,⁴ the Ninth Circuit denied deductions for lost "monopoly rights" when the State of Washington deregulated the intrastate motor carrier industry by eliminating restrictions on entry. The court reasoned that the taxpayer had not lost any rights conferred by the certificate of operating authority because the taxpayer was still permitted to do business and the operating

¹ See, e.g., *Reporter Publishing Co., Inc. v. Comm'r*, 201 F. 2d 743 (10th Cir.), cert. den., 345 U.S. 993 (1953) (no deduction allowed to newspaper for decline in value of its membership in Associated Press after exclusivity feature held to violate antitrust laws); *Monroe W. Beatty*, 46 T.C. 835 (1966) (no deduction allowed for diminution in a value of liquor license resulting from amendment of State law limiting grant of such licenses).

² See, e.g., *Alsop v. Comm'r*, 290 F. 2d 726 (2d Cir. 1961); *Marks v. Comm'r*, 390 F. 2d 598 (9th Cir.), cert. den., 393 U.S. 883 (1968) (no loss deduction for difference between actual earnings and what taxpayer's earnings would have been absent revocation of her teaching credentials).

³ *Consolidated Freight Lines, Inc. v. Comm'r*, 37 B.T.A. 576 (1938), aff'd, 101 F. 2d 813 (9th Cir.), cert. den., 308 U.S. 562 (1939); *Monroe W. Beatty*, *supra* note 1.

⁴ Note 3, *supra*.

authority had not given any further rights. Any "monopoly rights," the court stated, resulted from legislation and State administration restricting the availability of operating authorities. Since the taxpayer could not own (or purchase) property rights in legislation or regulations, repeal or modification of legislation or regulations did not give rise to a deductible loss, even if such action had the result of making the taxpayer's business property less valuable.

Issues

The principal issue is whether a taxpayer should be allowed a deduction on account of diminution in value of its business resulting from the Federal deregulation of any industry. A second issue is whether such a deduction should be a deduction for an ordinary loss or a capital loss.

If such a deduction is to be provided to motor carrier operators, other issues include whether the amount of the deduction should be limited to the taxpayer's adjusted basis (either in the certificate of operating authority or in its motor carrier business as a whole), and whether there should be an additional limit based on the actual loss of fair market value (either the value of the certificate or of the business as a whole) resulting from deregulation. Another issue is whether motor carrier businesses which held and benefited from certificates for a period of time before deregulation should be given the same tax relief as businesses which acquired their certificates shortly before deregulation.

Explanation of the bill

The bill provides that an ordinary deduction would be allowed ratably over a 36-month period for taxpayers who held one or more motor carrier operating authorities on July 1, 1980. The amount of the deduction would be the greater of \$50,000 or the total adjusted bases of all motor carrier operating authorities either held by the taxpayer on July 1, 1980 or acquired after that date under a binding contract in effect on July 1, 1980. (The minimum deduction of \$50,000 would be available even if that amount exceeds the operator's investment in its operating rights or exceeds the value of such rights.) The 36-month period would begin July 1, 1980 (or at the taxpayer's election, with the first month of the taxpayer's first taxable year beginning after July 1, 1980).

Under the bill, adjustments would be made to the bases of operating authorities held on July 1, 1980 (or acquired thereafter under a binding contract in effect on July 1, 1980) to reflect amounts that would be allowable as deductions under the bill.⁵

The bill also would provide special rules relating to component members of a controlled group of corporations. Under the bill, the controlled group would be treated as a single taxpayer. If the deduction of \$50,000 is allowed (exceeding the total adjusted bases of operating authorities held by the group on July 1, 1980), the deduction

⁵ The bill would not provide whether adjustments would be made to the bases of other property of the taxpayer if the deduction allowable under the bill exceeds the taxpayer's adjusted bases in operating authorities. This situation could arise under the bill if the adjusted bases of operating authorities are less than the alternative \$50,000 deduction.

would be apportioned among the component members in accordance with Treasury regulations.

Effective date

The provisions of the bill would be effective for taxable years ending after June 30, 1980.

Revenue effect

It is estimated that the bill would reduce budget receipts by \$40 million in fiscal year 1981, \$291 million in 1982, \$143 million in 1983, and \$55 million in 1984.

3. S. 738—Senator Durenberger

Advance Refunding of St. Paul Port Authority Revenue Bonds

Present law

Industrial development bonds—In general

In general, interest on State and local government bonds is exempt from Federal income tax (Code sec. 103(a)). However, with certain exceptions, this exemption does not apply to interest on State and local government issues of "industrial development bonds." An obligation constitutes an industrial development bond if (1) all or a major portion of the proceeds of the issue are to be used in any trade or business of a person other than a State or local government or tax-exempt organization, and (2) payment of principal or interest is secured by an interest in, or derived from payments with respect to, property, or borrowed money, used in a trade or business (sec. 103(b)(2)).

Under one exception to the general rule of taxability of interest on industrial development bonds, the exemption applies to such bonds if the proceeds are used to provide facilities for certain exempt activities. Such exempt activity facilities include convention and trade show facilities (sec. 103(b)(4)(C)) and airports, docks, wharves, mass commuting facilities, parking facilities, and storage or training facilities directly related to any of the foregoing (sec. 103(b)(4)(D)).

In general, in order to qualify as an exempt activity facility, the facility must satisfy a public use requirement; that is, it must serve or be available on a regular basis for general public use or be part of a facility so used (Treas. Reg. § 1.103-8(a)(2)). Transportation facilities in general satisfy the public use requirement if available for use by members of the general public or by common carriers or charter carriers which serve members of the general public (Treas. Reg. § 1.103-8(e)(1)). Also, a dock or wharf which is part of a public port satisfies the public use requirement (Treas. Reg. § 1.103-8(e)(1)). Convention and trade show facilities in general satisfy the public use requirement if available for an appropriate charge or rental for use by members of the general public. However, such facilities do not satisfy the public use test if use is limited by long-term leases to a single user or group of users (Treas. Reg. § 1.103-8(d)(1)).

Refunding bond issues

Present law restricts the availability of Federal income tax exemption with respect to "refunding issues" of those industrial development bonds which themselves qualify for interest exemption. In general, refunding issues are bonds from which the proceeds are used to redeem outstanding bonds. Refunding issues are issued typically to take advantage of lower current interest rates, or to remove restrictive covenants in the original bond issue.

Advance refunding issues are bonds issued more than six months prior to the retirement of the original bonds. In an advance refunding, both the original issue and the refunding issue remain outstanding.

In general, interest on an advance refunding issue of an industrial development bond is tax-exempt only if substantially all the proceeds of the refunded issue were used to provide a qualified public facility (Code sec. 103(b)(7)). Qualified public facilities, for this purpose, are (1) convention and trade show facilities and (2) airports, docks, wharves, and mass commuting facilities (and storage or training facilities directly related thereto) which are generally available to the general public.

Facilities that qualify as exempt activity facilities because they are available for use by common carriers or by charter carriers that serve members of the general public are not considered to be qualified public facilities for purposes of Code sec. 103(b)(7) unless those facilities directly serve the general public or are available on a regular basis for general public use. Also, facilities that are part of a qualified public facility are not considered to be qualified public facilities unless they also directly serve the general public or are available on a regular basis for general public use.

For example, a repair facility located in a public port that is owned by a nonexempt person, or leased to or assigned to a nonexempt person permanently or for the major portion of its useful life, does not meet the availability test if the facility does not provide services to the general public (e.g., repair services for all boats) or is not available on a regular basis for general public use. However, a facility that is owned by a governmental unit is considered to be available to the general public if it is leased to or assigned to a nonexempt person on a short-term basis, provided that the facility is available to the general public for a major portion of its useful life.

Issue

The issue is whether certain present law restrictions (relating to the public-use requirement) on advance refunding of industrial development bonds should apply in the case of the proposed advance refunding of revenue bonds issued by the Port Authority of the City of St. Paul, Minnesota, as well as whether those restrictions should apply in the case of any other issuer which could meet the requirements set forth in the bill.

Explanation of the bill

Under the bill, interest on a refunding issue of industrial development bonds would be exempt from Federal income taxation, without regard to whether the proceeds of the refunded issue were used to provide a qualified public facility, if certain requirements are met.

These requirements would be that: (1) the refunding issue is secured by a pledge of substantial revenues of the issuer derived from 20 or more facilities operated or leased by the issuer; (2) the refunding issuer is a political subdivision engaged primarily in promoting economic development; (3) the issuer was created under State law at least 20 years prior to the issuance of the refunding bonds for the express purpose of promoting economic development; and (4) any debt service savings derived from the refunding are to be used only

for the proper corporate purposes of the issuer and not to reduce any existing obligation of a nonexempt person (i.e., any person other than a State or local government or tax-exempt organization).

The intended beneficiary of the bill would be the Port Authority of the City of St. Paul, Minnesota. The Port Authority's revenue bonds are secured by a pledge of substantially all of its revenues derived from facilities owned by the Port Authority but leased to private companies. The Port Authority desires to refund its prior issues in order to relieve itself of restrictive covenants no longer required by existing market conditions and to reduce the debt service on its obligations. The bill would also benefit any other issuer that meets the requirements specified in the bill.

Effective date

The provisions of the bill would be effective on enactment.

Revenue effect

If the only beneficiary of the bill would be the Port Authority of the City of St. Paul, it is estimated that the bill would reduce budget receipts by \$3 million in fiscal year 1982 and by \$6 million annually in fiscal years 1983 through 1986. If other issuers also could meet the requirements of the bill, as introduced, the estimated reduction of budget receipts would be substantially greater.



